

**COORDINATED ISSUE
PETROLEUM AND RETAIL INDUSTRIES
CONVENIENCE STORES**

ISSUE

Whether gas station convenience store (C-store) buildings and truck stop structures are assets that can be treated as 15-year property and depreciated over 15 years or whether such assets are nonresidential real property subject to depreciation over 31.5 years (39 years for property placed in service after May 12, 1993) pursuant to IRC section 168(c)(1).

BACKGROUND

The C-store is a "convenience" store that, in addition to selling gasoline, offers a broad spectrum of consumer goods including groceries, beverages, household cleaning supplies, newspapers, magazines, picnic fare, and tobacco products. Typically, only about 10 to 20 percent of the facility's floor space is devoted to the marketing of petroleum products. This includes facilities such as counters relating to the sale of gasoline dispensed from pump islands, as well as automobile supplies such as oil, anti-freeze, and window-washer fluid (which are marketed along with the other consumer goods). The remainder of the C-store floor space is devoted to office area, storage, restrooms, food preparation, walk-in cooler, general sales area, and, in some cases, seating for customers. The C-store contains none of the features typically associated with traditional oil company service stations such as service bays, tire changing and repair facilities, and car lifts. The C-store provides no services relating to the maintenance of automobiles and trucks and employs no mechanics or other personnel who specialize in caring for motor vehicles. The typical employee resembles an employee found in other consumer goods retail facilities.

DISCUSSION

IRC section 167 provides the general rules governing the allowance for depreciation. Section 168 describes a specific depreciation system (Accelerated Cost Recovery System (ACRS)) for property placed in service after December 31, 1980. The depreciation system of section 168 was amended by the Tax Reform Act of 1986, and the Modified Accelerated Cost Recovery System (MACRS) was put in place for most property placed in service after December 31, 1986. Rev. Proc. 87-56, 1987-2 C.B. 674, sets forth asset classes for a wide variety of business activities and is used in conjunction with MACRS to determine proper depreciation recovery periods. Under Asset Class 57.1 service station buildings and other section 1250 property used in the marketing of petroleum and petroleum products are treated as 15-year property.

IRS section 168(e)(3)(E) was amended by section 1120 of the Small Business Job

Protection Act of 1996 (the Act). This section now provides that the term "15-year property" includes any section 1250 property that is a retail motor fuels outlet (whether or not food or other items are sold at the outlets). This provision is effective for property placed in service after August 19, 1996. Taxpayers may elect to apply the provision to MACRS property that was placed in service before August 20, 1996. The legislative history of the Act provides that if a taxpayer has already treated the property as 15-year property the taxpayer is deemed to have made the election. The legislative history also provides that if a taxpayer has not treated the property as 15-year property the Service may treat the election as an accounting method change and provide rules similar to those provided in Rev. Proc. 96-31, 1996-20 I.R.B. 11.

With respect to MACRS depreciation, the issue is whether the C-store is 15-year property or nonresidential real property depreciable over 31.5 years (39 years for property placed in service after May 12, 1993). The C-store will be treated as 15-year property if it is includable in Asset Class 57.1 or qualifies as a retail motor fuels outlet. Adjacent carwash buildings are accepted as Asset Class 57.1 property, as are associated land improvements, such as pump islands and canopies, used for the marketing of petroleum products. The tanks, pipelines, and pumps would fall into Asset Class 57.0, Distributive Trades and Services, with a MACRS recovery period of 5 years. The issue in dispute relates only to the C-store building itself.

As previously stated, Asset Class 57.1 includes service station buildings and other section 1250 property used in the marketing of petroleum and petroleum products. Critical factors in finding that the C-store building is not a service station building are the facts that the C-store does not possess any of the traditional attributes of a service station and that the C-store building is not a special purpose structure. Because a C-store does not provide the services offered by a traditional service station, we do not believe that a C-store building can be a "service station building" within the meaning of Asset Class 57.1. However, the building can still be treated as 15-year property if it is primarily used in petroleum marketing or is a retail motor fuels outlet.

In determining whether a C-store building is 15-year property, it is necessary to consider the statutory changes effected by the Act as well as the changes that have occurred in the petroleum marketing business over recent years. Therefore, the following 50 percent test (specified in S.Rep. No. 281, 104th Cong., 2nd Sess. 15 (1996)) is appropriate to determine whether a C-store building is 15-year property:

1. is 50 percent or more of the gross revenues generated by the C-store derived from gasoline sales, or
2. is 50 percent or more of the floor space in the building (including restrooms, counters, and other areas allocable to traditional service station "services") devoted to the petroleum marketing activity?

If a C-store building satisfies the test, the building is treated as 15-year property; otherwise, the building should be treated as an ordinary retail building. C-store buildings of 1400 square feet or less qualify under IRC section 168(e)(3)(E) regardless of whether the building meets the disjunctive test.

"Gross revenue" is defined as the revenue generated by the sale of the product to the consumer. For purposes of determining whether a C-store building qualifies as a retail motor fuels outlet, gross revenue includes all excise and sales taxes.

The gross revenue attributable to petroleum sales (gasoline and oil sales) should be compared to gross revenue from all other sources (e.g., food items, beverages, lottery, video rentals, etc.) If the petroleum sales are greater than the nonpetroleum sales, the building qualifies as 15-year property. The gross revenue should be analyzed for a full tax period. Temporary fluctuations in the results of the revenue analysis should not be used to determine whether the building qualifies or fails the gross revenue test. For example, if a special promotion is run for a 6-month period and the gross revenue ratio is temporarily affected, the primary use of the building should not be changed. If the building initially meets (or fails to meet) the disjunctive 50-percent test, but subsequently fails to meet (or meets) such test for more than a temporary period, such failure or qualification is a change in the use of the property.

Gross revenue should be analyzed on a building-by-building basis. Buildings with multiple businesses should include revenue of all the business activities owned or operated by the owner of the building. Of course, each other building located at the C-store site should be classified according to its primary use.

POSITION

The C-store building that meets the above-described test should be treated as 15-year property for depreciation purposes.